United States Department of Agriculture
FARM CREDIT ADMINISTRATION
Washington, D. C.

SUMMARY OF CASES

RELATING TO

FARMERS' COOPERATIVE ASSOCIATIONS

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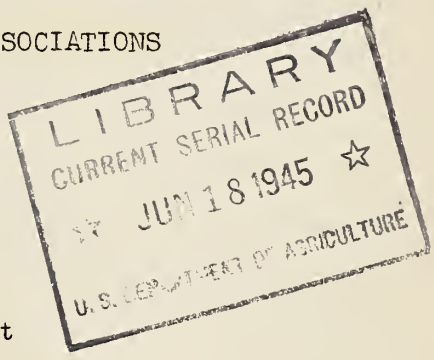

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Summary No. 26 June 1945

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Enforcement of National Labor Relations Board Order Denied

In the case of National Labor Relations Board v. Edinburg Citrus Association, 147 F.2d 353, the National Labor Relations Board brought a suit for the purpose of enforcing an order which it had issued, directing the Edinburg Citrus Association to cease and desist from discouraging membership in a labor organization and from interfering with its employees in exercising their right of self-organization, and that the Association reinstate two employees to their positions with back pay. The opinion of the court is here given in full:

> "The National Labor Relations Board asks enforcement of its order that Edinburg Citrus Association cease and desist from discouraging membership in a labor organization and from interfering with its employees in exercising their right of self-organization, and that it reinstate Opal Spurlock and Burnell McElhaney to their positions with back pay.
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> "The Association denies that commerce is so involved as to give the Board jurisdiction, and avers that its employees are 'agricultural laborers', specially excepted from the operation of the National Labor Relations Act by Section 2(3), 29 U.S.C.A. § 152(3). The Association is a co-operative corporation composed of Texas citrus fruit growers, which processes and packs only their fruit, and sells it in Texas to another company, which in turn ships most of it in interstate commerce, to a value of about $500,000 per year. Its crates and boxes and other supplies, costing about $100,000 per year, are bought in Texas from another company which imports about half of them in interstate commerce. While neither the Association nor its employees are engaged in interstate commerce, the stoppage of its operations by labor troubles would affect at once and to a considerable extent the flow of interstate commerce, as the Board found. This is enough to give it jurisdiction. 29 U.S.C.A. §§ 152(7), 160(a); N.L.R.B. v. Tex-O-Kan Mills Co., 5 Cir., 122 F. 2d 433.
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> "The employees are engaged in sorting and packing the fruit for market. It is done on a large scale in a large plant owned by the corporation. The employees do no field work and the corporation raises no fruit. Although packing fruit in the orchard in connection with its gathering by the producer would probably be agricultural labor, when the fruit raiser turns it over to a large packing plant to be mingled with the fruit of others, processed, packed and sold, the work becomes commercial rather than agricultural. North Whittier Heights Citrus Assn. v. N. L. R. B., 9 Cir., 109 F. 2d 76. Compare Chester C. Fosgate Co. v. United States, 5 Cir., 125 F.2d 775, in its interpretation of 'agricultural labor' in the Social Security Act, 42 U.S.C.A. § 301 et seq., before the meaning of the term was altered by amendment, and Lake Region Packing Assn. v.

United States, 146 F. 2d 157. The Association's workers in its packing plant are not agricultural laborers, though handling agricultural products.

"As to the unfair labor practices, the facts as found are that the two discharged employees worked in the packing shed at the more skilled and preferred work. The packers, all women and twenty-five in number, were Americans, while most of the workers elsewhere, more than one hundred in number, were Mexicans. The packers the year before had a union which had not worked well, and they had abandoned it with bitterness. A few weeks before the discharges a C. I. O. affiliate began to unionize the whole plant, including Mexicans, into one union. Spurlock and McElhaney were active in promoting it in the packing shed, but only one other packer joined and she was not active. The other packers were strongly opposed. Killough, the manager, and Hyde, the assistant manager, each told the employees several times there was no objection to them joining the union, but they did not have to join to keep their jobs. Killough told his foremen to 'keep their hands out of it one way or another', and told the workers in the packing shed that 'if they wanted to join the union it was all right, and if they did not want to join that was all right too; they could do as they pleased,' but he did not want them taking time off and running around and getting excited and causing lots of furor'. Hyde also told some of them not to discuss it in working hours. Hyde, however, hired both of these women knowing they were union members. They were capable workers. Racial antipathies were involved and feeling was bad between Spurlock and McElhaney on the one hand and the other packers on the other. Not only did the latter resent the efforts of the former to unionize, but they accused them of unfair and even dishonest practices in the sharing of the work. Spurlock quit her job because of these differences, but Hyde rehired her. Finally during a noon rest period twenty of the women were in the rest room and a really violent scene arose touching the unionization. Spurlock and McElhaney left the room, and the others sent two of their number to Killough to see if he would discharge them on a petition signed by the majority. They so asked him, and he said that 'if we intended to quit because we could not get along with two packers, that he wasn't going to let eighteen packers quit because they could not work with two others.' The committee reported, and the eighteen packers wrote and signed a statement: 'We the undersigned packers of Edinburg Citrus Assen. do hereby declare that the following packers, Opal Spurlock and Burnell McElhaney are and have been since their period of employment in this shed creating such a state of disturbance and unpleasantness that we do refuse to work with them'. Killough knew the signatures of his packers, and acting on this statement that afternoon he directed the discharge of the two women. They went to Killough and asked the reason, and he said 'I imagine you know'. They then showed their union button and organizer's card, and Killough asked, 'What do these have to do

with what you asked me?', and said to them, 'Your union membership wouldn't make any difference one way or another'. Hyde had nothing to do with the discharge. Some remarks by him to McElhaney that afternoon have no real bearing on it. Killough testified that to have lost eighteen packers that day would have shut down the plant, and that he did not discharge the two because of their union membership and activity. See N. L. R. B. v. Tex-O-Kan Flour Mills Co., 5 Cir., 122 F.2d 433, 438.

"This unfair labor practice by an employer is thus defined: 'By discrimination in regard to hire or tenure of employment or any term or condition of employment to encourage or discourage membership in any labor organization.' 29 U.S.C.A. § 158(3). We do not think these facts make such a case. These women were hired with knowledge of their union membership, and one of them was rehired. At the time of their discharge they were told that their union membership made no difference. All the employees had been repeatedly assured that such membership was immaterial to the employer, and the employer's only insistence was that they should not get excited and waste work time over the question. There is no reason to doubt that the discharges were made because the other employees refused to work with these two, and not from a discriminatory motive. We do not agree with the Board in the idea that because a part of the workers' objection to these employees was their union activity, the employer necessarily ratified and adopted that as the ground of his action. There was no collusion between Killough and the eighteen. If the eighteen had been union members, and the two not, his action would probably have been the same. The professed object of the National Labor Relations Act is to prevent interruptions of work in plants to the detriment of commerce. That is the ground on which Congress undertook to legislate. We do not think this plant had to be shut down, or should again be thrown into confusion, because two employees are unacceptable as coworkers to the others, whether the ground of it be just or unjust, or in part because of a union disagreement. There was here no employer discrimination within the meaning of the Act.

"Other evidence of interference with organization seems to us insufficient. Most of it relates to objection to union discussion in work hours. It is well settled that an employer may so object. An outburst of impatience by Hyde on one occasion he promptly apologized for. We do not think there is substantial evidence of employer interference with self-organization.

"We will accordingly refuse to enforce the order in this case."

Agricultural Labor - Social Security Taxes

In the case of Lake Region Packing Association v. United States, 146 F.2d 157, the association, a cooperative, brought suit "to recover sums collected

from it as social security taxes for the years 1936 to 1939, inclusive." It claimed that because it was "an agricultural cooperative, which, through its employees performed for its members the labor required to cultivate, pick, haul to market, package, process, and market their fruit, it and its employees were in effect employees of the members, and the work done by them was 'agricultural labor'" within the meaning of the applicable law and regulations.

The trial court held, and it was conceded, that "in respect of the labor performed for the care and cultivation of the fruit, the taxes had been wrongfully exacted", but held that the "labor employed in (1) picking and placing in the field boxes at roadside for hauling to the packing house; (2) hauling the field boxes full to the packing house and empty back; (3) processing, etc. in the packing house in preparation for marketing; and (4) marketing" was not agricultural labor and that social security taxes had lawfully been collected on account of such labor.

On appeal the court said that the cooperative cited no cases "In support of its position that as a cooperative concern it is merely the agent of the farmer so that its employees are the employees of the farmer within the meaning of the Social Security Act". The court, however, said that the cooperative cited cases which "do speak in a tone giving appellant spiritual, if not practical, that is legal, aid and comfort. Yakima Fruit Growers Ass'n v. Henneford, 182 Wash. 437, 47 P.2d 831, 100 A.L.R. 435; Tobacco Growers' Co-op. Ass'n v. Jones, 185 N.C. 265, 117 S.E. 174, 33 A.L.R. 231; Industrial Commission v. United Fruit Growers Ass'n, 106 Colo. 223, 103 P.2d 15; California E. Comm. v. Butte County Rice Growers Ass'n, Cal. Sup., 146 P.2d 908."

The court held, however, that "the provisions of the Social Security Act apply in the same way to all corporations alike, without distinction between those organized to obtain profits for their stockholders in the ordinary way and those organized to obtain them through cooperation."

The court further said: "We think it clear that appellant stands exactly in the same case as if it were a corporation organized in the usual way for the distribution of profits to its members, and that the principles laid down by the Fosgate case [Fosgate Co. v. United States, 125 F.2d 775] are controlling here."

The appellate court, however, held that -

> "To the extent, however, that the trial court found and held that the labor, of picking and placing in field boxes for hauling to the packing house, and that of hauling the field boxes to and from the field was not agricultural labor, he did not follow the Fosgate case, and therefore, erred. The statute exempts agricultural labor. To hold that the cultivation of the fruit was, and its picking, assembling and hauling was not, agricultural labor will not do. The statute contains no such limitation. Neither does the regulation

relied on to impose one contain it. It expressly declares that agricultural labor includes both the cultivating and the harvesting of the crops. Indeed, it goes further and holds that picking, packaging, transportation or marketing of farm products is agricultural unless such services were not carried on as an incident to ordinary farm operations as distinguished from ordinary manufacturing and commercial operations. If this packaging, processing, and marketing had been done by the individual farmers, or if without the organization of a corporation and the creation of a business as a result of that organization, the packaging had been done by the individual farmers through persons cooperatively provided and furnished to them as employees, all of the operations here in question would have been exempt. Our holding, however, that a cooperative corporation is no different from an ordinary corporation and the fact established and found that this corporation had an investment of around $200,000,00, and employed 150 to 200 persons, requires an affirmance of so much of the judgment as denied exemption in respect of the labor of packing and marketing. For it is quite clear that here is a case not of packing, processing and marketing as incidental to ordinary farming operations, but one, the essence of which was a commercial operation. Because this is so, those acts, which were not performed in the field or in connection with getting the product from the field to the place of processing and were therefore not per se agricultural, are deprived of their agricultural character by the dominance in the operation of their commercial character. The judgment was right except as to its denial of refunds for the labor employed in picking and hauling. In that respect it was erroneous."

Attention is particularly called to the fact that in the instant case, as in the Fosgate case, the suits brought by the plaintiffs were for the purpose of recovering social security taxes that were paid prior to the amendment of the Social Security Act effective January 1, 1940 (53 Stat. 1383), which sought to clarify the meaning of the term agricultural labor. If the case under discussion had arisen in connection with social security taxes that had been collected after January 1, 1940, there appears to be a basis for the view that the holding of the court might have been different. In this connection see Cache Valley Turkey Growers Association v. Industrial Commission (Utah) 144 P.2d 537, Summary No. 22, page 5.

In the opinion in the Utah case it was said:

"If the killing, dressing, cooling and grading of the farmers' turkeys done at the co-operative plant is an 'incident to ordinary farming operations' it is concededly agricultural labor. This phrase is not itself as clear as might be desired, but we are not wholly without aid as to its meaning. The federal amending act was passed pursuant to a report of a congressional committee defining it. The meaning and definition of the phrase 'as an incident to

ordinary farming operations' is given in Senate and House Committee Reports 76th Congress 1st Session, House Report No. 728, p. 53, Senate Report No. 734, p. 63. We quote from the latter report:

"'The expression "as an incident to ordinary farming operations" is, in general, intended to cover all services of the character described in the paragraph which are ordinarily performed by the employees of a farmer or by employees of a farmers' cooperative organization or group as a prerequisite to the marketing, in its unmanufactured state, of any agricultural or horticultural commodity produced by such farmer or by the members of such organization or group. * * * '"

In any instance in which the term "agricultural labor" is defined by statute, this of course is controlling.

See also in this connection Employment Security Commission v. Arizona Citrus Growers, 144 P. 2d 682, Summary No. 22, page 8.

In the case of In re Farmers Cooperative Creamery Co., decided by the Supreme Court of Idaho on January 24, 1945, 155 P.2d 762, the court held that truck drivers under contract with the cooperative creamery to haul milk for members and nonmembers were engaged in performing agricultural labor and hence that the cooperative was not liable for "unemployment compensation excise taxes" on account of their employment. The court said in part:

"It would therefore seem apparent that if the farmers individually delivered their milk from and in connection with their farms to respondent's creamery, they and their employees engaged in such work would be, under both the 1941 and 1943 statutes, engaged in an agricultural pursuit.

"The services performed by these drivers is thus essentially agricultural and is not divested of such characteristic because performed through, by means of and for a collective co-operative agency rather than by each individual farmer. Big Wood Canal Company v. Unemployment Compensation Division of the Industrial Accident Board, 61 Idaho 247, 100 P.2d 49; 139 A.L.R. 1165; Big Wood Canal Company v. Unemployment Compensation Division of the Industrial Accident Board, 63 Idaho 785, 126 P.2d 15; 146 A.L.R. 1321."

The statutes of Idaho, Chapter 182, 1941 Session Laws and Chapter 29, 1943 Session Laws defined agricultural labor insofar as pertinent here as that term was defined in the Federal social security laws as amended by the amendment effective January 1, 1940 (see 26 U.S.C.A. 1426(h)).

Director - Employed - Social Security Taxes

In the case of California Employment Stabilization Commission v. Sacramento Valley Walnut Growers Association (Cal. App.) 156 P. 2d 274, a suit

was brought for the purpose of recovering from the cooperative association "contributions under the California Employment Insurance Act, Stats. 1935, p. 1226, as amended, Deering's Gen. Laws 1937, Act 8780d, together with interest and penalties, upon the basis of wages paid by the association to certain employees during the period from January 1, 1938, to June 30, 1939."

At the trial of the case it was agreed that the only issue for determination was whether N. F. Todd "was an employee of defendant during such period, it being conceded that defendant corporation did not otherwise have a sufficient number of employees to become subject to the act."

Mr. Todd was a director and a member of the local cooperative association "and was designated by it to be its representative at meetings of the Central, and a member of Central's board of directors. During this period Todd made five trips to Los Angeles to attend meetings of the Central. In connection with these trips certain moneys were paid to him by defendant, and the question presented in this case is whether he was an employee of defendant within the meaning of the applicable statute."

As previously stated, the only issue for determination was whether Mr. Todd was an employee of the cooperative. If he was not an employee then it was agreed that the cooperative association was not under the statute. The trial court held that Todd was an employee, and the appellate court, in affirming the decision of the trial court, said in part:

> "The act here under consideration provides in section 6.5 that 'employment', subject to the other provisions thereof, 'means service ,* ,* ,* performed for wages or under any contract of hire, written or oral, express or implied.' Section 7 of said act excludes certain kinds of labor from the term 'employment', but is not pertinent here. The trial court in the case before us found that Todd was the representative of defendant for the purpose of representing it at the meetings of the Central; that as such representative he rendered services for defendant for which services he was paid $10 per diem; that in performing such services Todd was subject to the direction and control of defendant, not only as to the results to be achieved, but also as to the means and methods to be used in attaining such results; and that defendant had the right to discharge Todd at any time. From these facts it concluded that Todd was an employee of defendant, and that the remuneration received by him was wages. It thus appears that the trial court accepted appellant's contention as to what elements must appear in order to establish the relationship of employer and employee, but found that such elements appeared.
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> "However, in B. P. Schulberg Productions v. California Emp. Comm., Cal. App., 153 P. 2d 404, 406, it was held that the legislature did not intend to incorporate into the Unemployment Insurance Act the common law concept of master and servant, and that the words used in the act are not to be considered in their rigid, precise or

dictionary meanings, but rather as defined by the act itself which evidences a legislative intent to give the words a broad and liberal construction rather than to apply any narrow, technical or even previously established legal definitions.

"Giving the language of section 6.5 of the act such liberal construction the evidence in the case seems ample to establish that Todd performed services for defendant under a contract of hire, either express or implied; also that the compensation received by him was wages. But even applying the rule contended for by appellant, we think it cannot be said that there is not sufficient evidence in the record, together with reasonable inferences therefrom, to support the foregoing findings, bearing in mind that all reasonable presumptions are to be indulged in support of such findings (City of Los Angeles v. Knapp, 7 Cal. 2d 168, 172, 173, 60 P. 2d 127), and that the provisions of the California Employment Insurance Act are to be liberally construed to accomplish the social and economic purposes for which they were enacted (California Employment Commission v. Butte County, etc., Ass'n, supra, 154 P.2d at page 894).

"While appellant argues that moneys paid to Todd were merely for his expenses and not for his services, the Articles of Incorporation and By-laws of the Central were in evidence, and it appears therefrom that the Central itself paid the expenses of the directors. Art VI of those By-laws provides: 'The Directors shall receive such compensation and expenses as may be determined by the members'; and Mr. Hogan testified that money was furnished Todd by the Central to cover his expenses, though he stated that it was not enough. Also the minutes of the defendant association recite that Todd was to be paid $10 per diem for his services in attending meetings of the board of directors of central association; and we think that from the foregoing the trial court was fully justified in concluding that Todd was paid the $10 per day for services rendered by him to defendant.

"As to whether in performing his duties as the representative of defendant at meetings of the Central Todd was subject to the direction and control of defendant's board of directors, while there is no direct evidence that such board actually did direct him, there is no evidence that it did not, or that it did not retain the right to do so. Obviously, when Todd attended meetings of the Central he acted not for himself alone, but for the entire membership of defendant Local, and there is ample room for an inference that in representing the Local his actions and conduct were subject to direction by the directors of the Local, who designated him as such representative; at least that the directors had the right to direct him as to how he should vote on matters coming up before the Central for determination. In Social Security Board v. Warren, 8 Cir., 142 F.2d 974, the members of an executive committee of a corporation, of which committee Warren was a member, held weekly meetings at

8:30 a.m. for which services they were paid $5 per meeting. They determined matters of policy requiring action prior to the next meeting of the board of directors, approved loans already made, established credit for borrowers, and passed upon bills for expenses. There was no evidence that the directors had ever given any instructions to the members of the cimmittee as to what should be done by them, but the court said that they had a right so to do; and it was held that the payments to Warren constituted wages as found by the Social Security Board. Also see McKesson-Fuller-Morrison Co. v. Industrial Commission, 212 Wis. 507, 250 N.W. 396.

"From the fact that defendant's board of directors had the power to select its representative and fix his compensation for services, some right to control or direct his conduct is inferable; and the board apparently had the right to discontinue him as such representative at any time, which right is one of the elements of control. Hillen v. Industrial Acc. Comm., 199 Cal. 577, 581, 582, 250 P. 570; Press Pub. Co. v. Industrial Acc. Comm., 190 Cal. 114, 120, 210 P. 820."

In the case cited in the foregoing quotation, Social Security Board v. Warren, 142 F. 2d 974, the court quoted regulations of the Social Security Board reading as follows:

"Regulation No. 3 of Regulations of the Social Security Board, 20 C.F.R., 1940 Supp., § 403.804, provides in part as follows:

"'Every individual is an employee if the relationship between him and the person for whom he performs services is the legal relationship of employer and employee.

"'Generally such relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, * * * it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so.

* * * * *

"'* * * An officer of a corporation is an employee of the corporation, but a director as such is not. A director may be an employee of the corporation, however, if he performs services for the corporation other than those required by attendance at and participation in meetings of the board of directors.'"

The court in that case further said:

"The relation of employer and employee does not depend upon whether the authority is conferred upon a committee or an individual. It

depends upon whether the board of directors has a right to control the performance of the duty and whether its performance is compensated for in wages. Clearly the individual members of a committee may be found to be employees of a corporation when such committee is authorized for compensation to audit books and bills, or to perform any services useful or necessary in carrying on the business of the corporation."

As shown by the foregoing quotations, a director, when he is functioning strictly and solely as a director, is not by the regulations of the Social Security Board regarded as an employee. On the other hand, if a director is employed to do work for a corporation that other persons who are not directors might have been employed to perform, this appears to be sufficient to constitute him an employee.

Creditor or Stockholder - Interest or Dividends

In the case of Commissioner of Internal Revenue v. John Kelley Company, 146 F. 2d 466, the sole question for decision was whether certain disbursements or payments which had been made on income debentures as interest on indebtedness was actually interest or whether the amounts in question were in law dividends.

The company had deducted the payments made on the debentures as interest in computing its income taxes, but the Commissioner of Internal Revenue refused to allow the deduction of the so-called interest and held that the payments were dividends within the meaning of 26 U.S.C. 115(a) and hence were not deductible under 26 U.S.C. 23(b).

The Tax Court of the United States, in the case of John Kelley Company v. Commissioner, 1 T.C. 457, held in favor of the company, and the Commissioner of Internal Revenue then appealed the case to the Circuit Court of Appeals for the Seventh Circuit.

It appeared that the company had been originally formed with common and preferred stock. A so-called reorganization took place under which all of the preferred stock was exchanged for debentures on which interest at 8 percent per annum was payable out of net income. In holding that the interest paid on the debentures was dividends the court said in part:

"The 8% interest on the debentures was payable only out of the net income of the company. If there was no income, there were no payments, and defaulted payments did not accumulate. At liquidation or insolvency, the debenture holders were superior in rank only to the common stockholders, just as were the former preferred stockholders. All other creditors had preference. The preference of the debenture holders over the stockholders meant nothing, because all the debentures were held by stockholders, either individually or as trustees. The debenture holders had no voice in management. That, too, was of little moment, for the same reason.

"On the books of the company the income debentures were referred to variously as 'stocks,' 'bonds,' and 'notes.' In the capital stock tax returns for 1938 and 1939, the 'debentures' and 'debenture notes' were listed as capital stock. They were not reflected as indebtedness in the balance sheets appearing in the income and excess profits tax returns filed by the respondent for 1937, 1938, and 1939, but appeared under the heading, 'Capital Stock: Debenture Notes.' On most of the checks drawn to make the income payments on the debentures, the nature of the payment was described as 'Interest, income debenture stock.'

* * * * *

"Stockholders take the risks of a business while creditors must be paid whether the corporation has a net income or not. The distinguishing feature of one is risk, and of the other, security. In the case at bar, the debenture owners were not to be paid in any event but were to be paid only after all other creditors were paid; and the 'interest' on the debentures was to be paid only if sufficient net income was earned within the period. Such debentures obviously evidenced risk capital, not creditor capital. In short, it was all a matter of accounting hocus-pocus, guided by a little too clever legal planning which eventuated in a rather flimsy scheme to avoid paying of taxes. As far as we are concerned, it will not succeed.

"No case has been decided where the facts so clearly characterized the document as stock. A consideration of cases in the Circuit Courts of Appeals and the District Courts discloses none where noncumulative payments, payable out of earnings only, have been held to be interest."

For a case in which a similar conclusion was reached, see Green Bay and W.R. Company v. Commissioner of Internal Revenue, 147 F. 2d 585.

In any instance in which the so-called dividends are paid from deductions made from sale proceeds for that specific purpose, or from payments made to an association to provide money for the payment of the dividends and the association is simply seeking to compensate those who furnished it with capital, there would appear to be a sound basis for the view that the dividends are actually interest payments and hence deductible in computing income taxes of a nonexempt association. This is the principle that was followed in the case of Garden Homes Company v. Commissioner of Internal Revenue, 64 F. 2d 593, in which fixed dividend payments of 5 percent were regarded as interest and held to be deductible by a nonexempt organization in computing its income taxes. The organization was a nonprofit cooperative housing corporation, and all the expenses, including the dividends, were deducted from the rent paid monthly by tenants and the balance was applied toward the purchase of common stock by the tenants in the corporation that owned the houses. As common stock was purchased by tenants a corresponding amount of preferred stock that was owned by

those who originally financed the corporation was retired. The payment of the fixed dividends of 5 percent was obligatory and not discretionary, and the court held that although the disbursements were made as dividends they were actually interest payments and hence were deductible. In United States v. Title Guarantee and Trust Company, 133 F. 2d 990, payments made as dividends on stock were held to be interest payments because the evidence showed that the relation between the parties was that of debtor and creditor.

In the recent case of United Cooperatives, Inc. v. Commissioner of Internal Revenue, 4 T.C. 93, the Tax Court of the United States held that the cooperative was required to pay income taxes on amounts that the cooperative was authorized to distribute in dividends, although no dividends had in fact been paid. Apparently the Tax Court was unwilling to adopt the view that the dividends were actually interest.

In a footnote to the opinion of the court in the case of Commissioner of Internal Revenue v. Meridian and Thirteenth R. Company, 132 F. 2d 182, 185, the court enumerated the following tests for determining whether the relationship between a corporation and another, arising from documents, was that of "creditor or stockholder":

> "Fixed maturity; payment of dividends out of earnings only; cumulative dividends; participation in management; whether unpaid dividends bear interest; right to sue in case of default, and whether status is equal to, or inferior to that of regular corporate creditors; nomenclature used in the documents; intent of the parties."

As shown by the foregoing, disbursements made by a nonexempt corporation as interest have been held to be dividends and hence not deductible in in computing income taxes, and on the other hand some disbursements made as dividends have been held to be interest and hence deductible. If it is intended that disbursements made as interest will be deductible, care must be exercised to see to it that they technically qualify as interest.

In Equitable Society v. Commissioner, 321 U.S. 560, 564, the court said:

> "Yet payments made wholly at the discretion of the company have a degree of contingency which the notion of 'interest' ordinarily lacks. If we expanded the meaning of the term to include these excess interest dividends, we would indeed relax the strict rule of construction which has obtained in case of deductions under the various Revenue Acts. New Colonial Co. v. Helvering, 292 U.S. 435, 440; Deputy v. DuPont, supra, p. 293."

Reorganization Held Invalid

The Farmers Elevator of Eustis, Nebraska, was organized under the general corporation laws of Nebraska as a stock corporation and not as a cooperative association. Stockholders of the corporation took action with the

view of converting the organization into a cooperative association and "certain amendments to the articles of the corporation were adopted which purported to change The Farmers Elevator to a cooperative corporation and provided for the distribution of dividends upon a patronage basis. Subsequently the officers and directors adopted bylaws in conformity with the amended articles ***."

Certain of the stockholders who had not acquiesced in the attempt to amend the articles of incorporation and bylaws filed a suit for the purpose of enjoining the corporation from distributing the earnings of the corporation on a patronage basis, and the trial court issued an injunction preventing the payment of patronage dividends. The association then appealed the case to the Supreme Court of Nebraska (Hueftle v. Farmers Elevator, 16 N.W. 2d 855. On appeal the court said:

> "The fundamental question to be determined is whether the adoption of amended articles of incorporation by a majority of the stockholders, whereby it is sought to convert a stock corporation organized under the general corporation laws of the state into a co-operative corporation distributing dividends on a patronage basis, is violative of the contractual rights of minority stockholders and constitutes such a fundamental change in the nature, purposes and objects of the corporation as to make such amendments invalid.
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> "The purpose of the suit is to prevent the distribution of the profits of the corporation in the manner provided by the amended articles and bylaws. It is self-evident that stockholders under the original articles will be deprived of dividends to which they were entitled thereunder. By their purchase of stock they acquired a contractual right to share in the net profits in the form of dividends on stock. An attempt to make a distribution of net profits on a patronage basis constitutes a violation of plaintiffs' contract rights.
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> "'It is settled law that a corporation has no power to adopt by-laws which impair or destroy the obligations of contracts or rights thereunder or vested rights, and that by-laws which have that effect are invalid and unenforceable against a person whose rights are impaired or destroyed thereby.' 8 Fletcher, Private Corporations (Perm. ed.) sec. 4188. The foregoing rule applies with equal force to amendments to the bylaws."
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> "In a case very similar on fact and principle this court said: 'In 1916 there was an attempt to amend the articles of incorporation by changing the Farmers Elevator Company to a co-operative association within the meaning of the statute cited. Later defendants planned to distribute profits under the amendment. Such a course, if pursued, would deprive plaintiffs of dividends to which they were entitled under their contracts as original stockholders and would destroy their contractual rights. This neither the legislature nor

the defendants can lawfully do.' Allen v. White, 103 Neb. 256, 171 N.W. 52.

"In Supreme Commandery Knights of the Golden Rule v. Ainsworth, 71 Ala. 436, 46 Am. Rep. 332 the court said: 'A corporation has not capacity, as the legislative power from which it derives existence has not competency, by laws of its own enactment, to disturb or divest rights which it had created, or to impair the obligations of its contracts, or to change its responsibilities to its members, or to draw them into new and distinct relations.'

"The amendments change the fundamental arrangement and plans of the corporation as it was organized when plaintiffs became stockholders and impair the contractual rights which they then acquired. It follows that the amendments and the proceedings of the defendants taken thereunder are void."

The defendants urged that the plaintiffs were estopped to question the validity of the articles and bylaws because they had permitted the corporation to advertise and solicit business for approximately seven months without objection, but the court held that a delay of seven months was not unreasonable "where, as here, no effort was made to distribute dividends on a patronage basis until shortly before the suit was brought."

This is an instance in which a corporation that was originally organized to function as a commercial concern attempted to reorganize so as to permit it to function on a cooperative basis. The fundamental character of the corporation was involved. The power to amend the articles of incorporation has been held insufficient to authorize an amendment that would permit a corporation to engage in a different type of business from that originally authorized. Midland Co-op. Wholesale v. Range Co-op. Oil Ass'n, 200 Minn. 538, 274 N.W. 624, 111 A. L. R. 1521. The plaintiffs who instituted the suit had not taken stock in a cooperative corporation and had not acquiesced in converting the corporation into a cooperative. Under these circumstances it is believed that ordinarily a commercial corporation may not be converted into a cooperative against the will of stockholders who do not acquiesce in such action. There have been cases in which such corporations have found it possible to dispose of their assets to a cooperative association and the stockholders of the old corporation that were desirous of doing so would become members of the new, and their "interest" in the assets of the old corporation would be transferred to the new corporation and they would receive certificates from the new corporation covering their equities, while those stockholders of the old corporation who were unwilling to become members of the cooperative would receive their share of the assets of the old corporation in cash or otherwise. It is not always possible for this procedure to be followed because in most of the States a corporation may not dispose of all of its assets unless it is in a failing condition, without the consent of a specified percentage of its stockholders. It was said in Voigt v. Rerick, 260 Mich. 198, 244 N.W. 446, that "At common law neither the directors of a corporation nor a majority of its

stockholders had the right, power, or authority to sell and convey all the property of a going and prosperous corporation capable of achieving the objects of its creation as against the objections of a single stockholder."

There are statutes in many of the States which deal specifically with the sale of all the assets of a going corporation, and any such statute should be carefully observed.

In quite a good many of the States there are provisions in the cooperative acts under which corporations or associations incorporated under other statutes may reincorporate. The Supreme Court of Minnesota in the case of Maclaren, as Receiver of Goodhue County Co-operative Company v. Wold, 168 Minn. 234, 210 N.W. 29, 55 A.L.R. 321, 172 Minn. 334, 215 N.W. 428, expressed doubt as to the constitutionality of a provision of this character. In the North Dakota case of Mohall Farmers' Elevator Company v. Hall, 44 N.D. 430, 176 N.W. 131, 133, the Supreme Court of North Dakota held "that the secretary of state cannot be heard to assert in this proceeding that the rights of nonconsenting stockholders have been or may be violated", and ruled that the reincorporation papers must be filed by him. Of course, if all the stockholders of the corporation agree to the reincorporation no constitutional question would arise.

Holder in Due Course

Members of the California Cooperative Producers, "As a consideration for processing and marketing their fruit by the corporation * * * signed written agreements to extend their credit to the corporation by the execution of their promissory notes in amounts to be determined by the tonnage of fruit delivered." These notes were installment notes.

On April 17, 1928, the cooperative borrowed $5,000 and pledged three notes executed by producers in its favor as security therefor. The cooperative went into bankruptcy after it had defaulted on the payment of its note for $5,000. Thereupon the holder of the note brought a suit on the notes given by the members of the cooperative (Bliss v. California Co-op Producers (Cal. App.) 154 P. 2d 929). On appeal the court upheld the judgment of the trial court in favor of the plaintiff.

It was urged on appeal that the plaintiffs were not holders in due course and that there was a failure of consideration for the notes, and that the notes were delivered to the plaintiffs conditionally and not otherwise, and that the notes were procured by fraud. The appellate court affirmed the determination of the trial court that the plaintiffs acquired each of the notes in good faith for a valuable consideration without notice of any defect before it was overdue and before any installment thereof was overdue, and therefore held that the plaintiffs were holders in due course and that this operated to cut off all of the other defenses which the defendants endeavored to make. In this

connection the appellate court cited Section 3138 of the Civil Code of California which reads as follows:

> "A holder in due course holds the instrument free from any defect of title of prior parties, and free from defenses available to prior parties among themselves, and may enforce payment of the instrument for the full amount thereof against all parties liable thereon."

Incorporators and Subscribers for Stock - Liable for Debts

In Schoenburg v. Klapperich, 239 Wisc. 144, 300 N.W. 239, the question for decision was whether the statute of Wisconsin which forbade a corporation from doing business with persons other than its members before 50 percent of its capital stock had been subscribed and 20 percent of its authorized capital stock actually paid in, was applicable to a cooperative association. The statute in question of Wisconsin, insofar as material to this discussion, reads as follows:

> "180.06(4): 'The corporation shall not transact business with any other than its members until one-half of its capital stock shall have been subscribed and one-fifth of its authorized capital actually paid in. * * * If any obligation shall be contracted in violation hereof, the corporation offending shall have no right of action thereon; but the signer or signers of the articles and the subscriber or subscribers for stock transacting such business or authorizing the same, or having knowledge thereof, consenting to the incurring of any debt or liability, as well as the stockholders then existing, shall be personally liable upon the same.'"

This statutory provision was a part of the general corporation laws of Wisconsin. Originally the law of Wisconsin provided:

> "No association organized under sections 1786e - 1 to 1786e - 17, inclusive [relative to cooperative associations], shall be required to do or perform anything not specifically required herein, in order to become a corporation or to continue its business as such."

In 1921 this statutory provision was stricken by an amendment and the following provision substituted therefor:

> "The general corporation law of this state shall apply to all associations organized under sections 1786e - 1 to 1786e - 17, inclusive, except where said general corporation law expressly exempts such association or where the provisions of said general corporation law are opposed to or inconsistent with the provisions of sections 1786e - 1 to 1786e - 17, inclusive."

This latter section has since been renumbered and is now section 185.20, Stats. Chapter 490, Laws of 1921, further amended section 1786e - 17 to provide:

> "Every corporation or association in existence at the time of the passage of this act which is affected by any provision hereof, shall have until July 1, 1922, to comply with such provision."

The trial court held that the statutory provision making incorporators and subscribers for stock liable for the debts of the corporation if business was transacted with third persons before the requisite amount of the capital stock of the corporation had been subscribed and the requisite amount of its authorized capital stock paid in, was inconsistent with the provisions of the cooperative act under which the cooperative association was incorporated.

On appeal, however, the Supreme Court of Wisconsin held that there was no inconsistency between the cooperative act and the statutory provision in question. In this connection, among other things the court said:

> "The creditors of a cooperative association incorporated under chapter 185, Stats., are entitled to the same protection as afforded creditors of other corporations by having 50% of the authorized capital stock subscribed for and at least 20% actually paid in. The short life of the instant corporation, Associated Buyers Cooperative, Inc., clearly demonstrates the necessity of a capital structure such as section 180.06(4), Stats., requires before the corporation may transact business and incur obligations with others than its own members. We take judicial notice of the records in the office of the secretary of state from which it appears that Associated Buyers Cooperative, Inc., was incorporated on September 9, 1939, and from the pleadings in the instant case it appears that it was adjudged insolvent on June 11, 1940.
>
> "We must hold that section 180.06(4), Stats., is applicable to cooperative associations which are organized as corporations under chapter 185, Stats., and that section 185.20, Stats., incorporates the general corporation laws in said chapter 185, Stats. The general corporation law, which requires that a corporation must have 50% of its authorized capital stock subscribed for and at least 20% actually paid in before it may transact business or incur obligations with others than its own members, is not opposed to or inconsistent with the provisions of chapter 185, Stats."

In quite a few of the States there are statutory provisions making the incorporators and subscribers for stock liable for its debts if a corporation transacts business with third persons before the requisite amount of capital is subscribed and paid in. Again, many of the cooperative statutes provide that the general corporation laws of the State are applicable to cooperative associations unless inconsistent therewith.

The instant case emphasizes that such a statute might be held applicable to cooperative associations formed under a cooperative act. In organizing a cooperative association with capital stock care should be exercised to ascertain if there are any statutory provisions of the State imposing liability on incorporators and subscribers for stock, and the applicability of such statutory provisions to a cooperative association should be determined.

What Constitutes Notice of a Marketing Contract

In the case of Neillsville Shipping Association v. Lastofka (Wis.) 274 N.W. 280, it appeared that the defendant had purchased livestock from one of the members of the shipping association who was under contract to market all of his livestock, subject to certain exceptions that were not material, through the association. The association filed the marketing contract with the register of deeds of the county in which the member lived, but apparently there was a question as to whether it had been correctly indexed by the register of deeds. The trial court held that the association was not entitled to enjoin the defendant from purchasing livestock from any of its members and that it was not entitled to recover from the defendant the value of the livestock which he had purchased.

On appeal the Supreme Court of Wisconsin held that the association was entitled to enjoin the defendant from purchasing livestock from any of its members. The following quotation from the opinion shows the statutory provisions under which the association was proceeding:

> "Section 185.08 (6) provides:
>
> 'Where any contract exists between an association and a member, any person who, with knowledge or notice of the existence of the contract, induces or attempts to induce or aids in the breach thereof by any means, shall be liable to the aggrieved party for damages on account of such interference with said contract and shall also be subject to an injunction to prevent the interference or further interference therewith.'
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> "It was under this subsection that this action was brought and the question is: Did the court err in refusing, under the undisputed facts, to make the temporary injunction permanent? The court was apparently of the view that it had a discretion either to grant or to refuse an injunction. In our view, subsection (6) does not so provide. Subsection (5) in part provides:
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> 'From and after the date of such filing the same shall constitute notice to any and all persons that an interest in the title to all property so agreed to be sold by the maker of such contract during the term of such contract is vested in the said association. In case of a purchase thereafter of any such property by any party

other than the association from any party other than the association, no title of any kind or nature shall pass to such other purchaser, and the said association may recover the possession of such property from any and all such other parties or from any party in whose possession the same may be found, by replevin action, or may sue for an injunction.'

"These two sections just hereinbefore quoted, construed together, quite clearly show that a co-operative association has several remedies for the protection of its business: (1) Replevin, when the property may be found in the possession of some person; (2) an injunction; and (3) an action to recover damages for interfering with its contract."

The defendant contended that inasmuch as he had been informed by Galbreath, the member of the association in question, that he was no longer a member of the association, that this operated to relieve him from any liability to the association. The appellate court, however, held that inasmuch as this information was sufficient to put the defendant on notice that Galbreath had been a member of the association, that defendant was obligated to make further inquiries to ascertain if Galbreath continued in fact to be a member of the association and under contract to market his livestock through the association. In this connection the court said:

"Whether the record of the Galbreath contract in the office of the register of deeds was sufficient to give constructive notice, we need not presently decide, for the reason that under the undisputed facts the defendant did know that Galbreath had been a member of the association. While Galbreath told the defendant that he was no longer a member of the association, that was a misrepresentation which in no manner affected the rights of the plaintiff association under its contract with Galbreath. The defendant must be presumed to have known the law that such a contract remains a valid contract as to all persons until its expiration according to its terms or until canceled by mutual agreement in writing or by the final judgment of a court in an action to annul the same and that whenever such a contract shall have terminated in any of the ways above mentioned the association shall, on demand, give to the member a certificate to be filed with the register of deeds in whose office the copy thereof was filed. Section 185.08 (7). When the defendant was told by Galbreath that his membership in the association had terminated, the defendant received actual notice of the fact that Galbreath had been a member of the plaintiff association, a fact sufficient to put him, as a prudent man, upon inquiry, which if prosecuted with ordinary diligence, would have led to actual notice of the existence of the contract. Brinkman v. Jones, 44 Wis. 498, 519; New Dells Lumber Co. v. Pfiffner, 216 Wis. 638, 258 N.W. 375. The defendant resided at Neillsville. Had he made inquiry at the office of the register of deeds for the purpose of ascertaining whether Galbreath's contract was still in existence, before going

to Galbreath's farm, he no doubt would have been correctly informed as to the fact. Co-operative contracts may not be so easily circumvented. We conclude that under the facts of this case the plaintiff association was entitled to a permanent injunction restraining the defendant from interfering with its contracts in the future."

The court further held that the association was not entitled to recover $80, the actual value of the livestock purchased, but that the association was restricted to recovering the actual damages which it had sustained by reason of the fact that the livestock in question was not marketed through the association.

The trial court did not pass on the question of whether the marketing contract had been filed and indexed as required by law, and the appellate court found it unnecessary to determine if the record of the marketing contract with the register of deeds was sufficient compliance with the statute to put the defendant on inquiry regarding the rights of the association.

There are quite a number of States that have made provision for the filing of record with recording officers of marketing contracts, and the object, of course, of filing them of record is to give notice to all the world of the rights of the associations.

It will be remembered that entirely independent of statute and in accordance with the general principles of equity that "A purchaser with notice of a prior contract to sell or to lease takes subject to such contract, and is bound in the same manner as his vendor to carry it into execution; ***" (Pomeroy's Equity Jurisprudence, 3d ed., sec. 688, p. 1385). See also Union Pacific Railway Co. v. McAlpine, 129 U.S. 305, 9 S. Ct. 286, 32 L. Ed. 673; Gore v. Condon, 82 Md. 649, 33 A. 261; California Grape Control Board, Ltd. v. Boothe Fruit Company, 220 Cal. 279, 29 P. 2d 857; Pacific Wool Growers v. Draper & Co., 158 Ore. 1, 73 P. 2d 1391.